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# In the
# Supreme Court of the United States.

OCTOBER TERM, 1979.

No. 79-762

LUIGI M. DiFONZO,
PETITIONER,

*v.*

UNITED STATES OF AMERICA,
RESPONDENT.

**Petition for a Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit.**

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## Table of Contents.


| | |
|---|---|
| Opinions below | 1 |
| Jurisdiction | 2 |
| Questions presented | 2 |
| Statutory provisions involved | 3 |
| Statement of the case | 3 |
| Reasons why the writ should be granted | 5 |
| I. The Securities and Exchange Commission possessed no regulatory jurisdiction over petitioner's commodities business. Accordingly, any false statements submitted to the Securities and Exchange Commission were not made in a matter within its jurisdiction as required for a prosecution under 18 U.S.C. § 1001 and the indictment failed to state an offense | 5 |
| II. Where, in an indictment charging a violation of 18 U.S.C. § 1001, the nature of petitioner's commodity business is set forth in a number of factual allegations in the indictment, the failure to allege affirmatively that his business was engaged in any of the limited class of transactions even arguably within the jurisdiction of the Securities and Exchange Commission renders the indictment facially insufficient for failure to state an essential element of the offense charged — i.e., agency jurisdiction over petitioner's business | 11 |
| Conclusion | 17 |
| Appendix | follows page 17 |
| Opinion of United States Court of Appeals for the Seventh Circuit | 1a |

Judgment of United States Court of Appeals for the Seventh Circuit 11a
Order on petition for rehearing of United States Court of Appeals for the Seventh Circuit 13a
Indictment No. 78CR-56 14a

## Table of Authorities Cited.

### CASES.

Glazer v. National Commodity Research & Statistical Service, Inc., 388 F. Supp. 1341 (N.D. Ill. 1974) 7n
Glazer v. National Commodity Research & Statistical Service, Inc., 547 F. 2d 392 (7th Cir. 1977) 5n, 7, 10
Hirk v. Agri-Research Council, Inc., 561 F. 2d 96 (7th Cir. 1977) 7, 10
International Brotherhood of Teamsters v. Daniel, 439 U.S. 551 (1979) 7n
Marteney v. United States, 216 F. 2d 760 (10th Cir. 1954) 13, 14, 16
Milnarik v. M-S Commodities, Inc., 457 F. 2d 274 (7th Cir. 1972), cert. den. 409 U.S. 887 (1972) 5n, 7, 10
Russell v. United States, 369 U.S. 749 (1962) 13
SEC v. W.J. Howey Co., 328 U.S. 293 (1946) 7
Tcherepnin v. Knight, 389 U.S. 332 (1967) 7n
United Housing Foundation, Inc. v. Forman, 421 U.S. 837 (1975) 7n
United States v. DiFonzo, 603 F. 2d 1260 (7th Cir. 1979) 1



United States v. King, 587 F. 2d 956 (9th Cir. 1978) 13, 14, 15
United States v. Seeger, 303 F. 2d 478 (2d Cir. 1962) 15, 16

### STATUTES.

2 U.S.C. § 192 15
7 U.S.C.
§ 2 8n, 9n
§ 6a 9n
§ 6c 8n
15 U.S.C. (1970)
§ 77b(1) 8n
§ 78c(10) 8n
18 U.S.C.
§ 1001 3, 4, 5, 6, 10, 11
§ 2314 13
28 U.S.C. § 1254(1) 2
Grain Futures Act, Act of September 21, 1922, c. 369, § 1, 42 Stat. 99 8n
Securities Act of 1933 6, 7n, 8n
Securities and Exchange Act of 1934 6, 7n, 8n
Commodity Exchange Act, Act of June 15, 1936, c. 545, § 1, 49 Stat. 1491 8n, 9
Commodity Futures Trading Commission Act, Act of October 23, 1974, Pub. L. 93-463, 88 Stat. 1389 7n, 8n, 9

LEGISLATIVE MATERIALS.

120 Congressional Record (1974)
10726 8n
10736 9n
10740 9n
10747 8n
30458 8n
H. Rep. No. 93-975, 93d Cong., 2d Sess. (1974) 9n
Review of Commodity Exchange Act and Discussion of Possible Changes: Hearings before the Committee on Agriculture, H. Rep., 93d Cong., 1st Sess. (1973) 8n
S. Rep. No. 93-1131, 93d Cong., 2d Sess., reprinted in 1974 U.S. Code Cong. Adm. News 5859 8n

MISCELLANEOUS.

Federal Rules of Criminal Procedure, Rule 7 3, 12

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UNITED STATES OF AMERICA,
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**Petition for a Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit.**

Luigi M. DiFonzo petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Seventh Circuit entered in this case on August 2, 1979, and October 15, 1979.

## Opinions Below.

The Court of Appeals for the Seventh Circuit issued an opinion on August 2, 1979, which is reported at 603 F. 2d 1260. The opinion is reproduced in the appendix at pp. 1a-10a. The

order entered on October 15, 1979, denying DiFonzo's petition for rehearing, is reproduced in the appendix at p. 13a.

## Jurisdiction.

The original judgment of the Court of Appeals was entered on August 2, 1979. A timely petition for rehearing was denied on October 15, 1979. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

## Questions Presented.

Whether, in 1973, the Securities and Exchange Commission ("SEC") had statutory authority to investigate and regulate petitioner's commodities business, described in the indictment as one trading in commodity futures contracts or commodity futures option contracts, particularly where the United States Court of Appeals for the Seventh Circuit — the jurisdiction in which the business was operated — had held that neither commodity futures contracts, discretionary trading accounts nor commodity options were subject to the jurisdiction of the SEC?

Whether, assuming *arguendo* SEC jurisdiction over certain limited types of commodity accounts, an indictment fails to state an offense when agency jurisdiction is an essential element of the offense charged and the preliminary factual allegations describing petitioner's commodities business do not affirmatively allege that the business participated in the limited forms of commodity trading arguably within the jurisdiction of the SEC?



## Statutory Provisions Involved.

18 U.S.C. § 1001 provides:

> "Whoever, in any matter within the jurisdiction of any department or agency of the United States knowingly and willfully falsifies, conceals or covers up by any trick, scheme, or device a material fact, or makes any false, fictitious or fraudulent statements or representations, or makes or uses any false writing or document knowing the same to contain any false, fictitious or fraudulent statement or entry, shall be fined not more than $10,000 or imprisoned not more than five years, or both."

Rule 7 of the Federal Rules of Criminal Procedure provides in pertinent part:

> "(c) **Nature and Contents.**
>
> "(1) **In General.** The indictment or the information shall be a plain, concise and definite written statement of the essential facts constituting the offense charged. . . ."

## Statement of the Case.

On February 1, 1978, petitioner was charged in a three-count indictment with violating 18 U.S.C. § 1001 by knowingly submitting three documents to a representative of the SEC containing "materially false, fictitious and fraudulent" statements. Each count also alleged that the documents were submitted "in a matter within the jurisdiction of the S.E.C." The documents emanated from petitioner's business — described

in the indictment as a "commodity option business"; as one "which sold commodity options to the public." As part of his operation of the commodities business petitioner was alleged to have caused his business "to buy and sell commodity futures by use of various commodity brokerage firms" (App. 14a-17a).

Petitioner moved to dismiss the indictment for failure to state an offense under 18 U.S.C. § 1001 on the grounds that the indictment on its face alleged facts showing that the SEC did not have jurisdiction over petitioner's commodity option business and that any alleged false statements were therefore *not* made in "a matter within the jurisdiction of the S.E.C." and were not material to any matter within the jurisdiction of the SEC as required by § 1001. After the District Court denied petitioner's motions to dismiss, petitioner entered a plea of guilty to counts 2 and 3 of the indictment. Count 1 was dismissed by the government.

On appeal, the United States Court of Appeals for the Seventh Circuit held that the issues raised on appeal survived petitioner's plea of guilty, but disagreed with his contention that the preliminary factual allegations of the indictment describing petitioner's business, on their face, rendered the indictment invalid for failure to state an offense since they failed to demonstrate that any false statements related to a matter within the jurisdiction of the SEC or were material to a matter within the jurisdiction of the SEC. The court predicated its holding that the false statements were submitted in a matter within the jurisdiction of the SEC on the fact that the factual allegations did not preclude the possibility that petitioner's business was engaged in two particular forms of commodity trading — discretionary trading accounts or naked double options — which could, according to the court, arguably have



fallen within the jurisdiction of the SEC, as interpreted by other courts.[1]

Petitioner's timely petition for rehearing and suggestion for rehearing en banc was denied by the court on October 15, 1979 (App. 13a).

## Reasons Why the Writ Should be Granted.

I. THE SECURITIES AND EXCHANGE COMMISSION POSSESSED NO REGULATORY JURISDICTION OVER PETITIONER'S COMMODITIES BUSINESS. ACCORDINGLY, ANY FALSE STATEMENTS SUBMITTED TO THE SECURITIES AND EXCHANGE COMMISSION WERE NOT MADE IN A MATTER WITHIN ITS JURISDICTION AS REQUIRED FOR A PROSECUTION UNDER 18 U.S.C. § 1001 AND THE INDICTMENT FAILED TO STATE AN OFFENSE.

This case presents interlocking and unresolved questions concerning the scope of the jurisdiction of the SEC over the commodities trading industry and, assuming *arguendo* SEC jurisdiction over a limited class of commodities transactions, the facial sufficiency of an indictment charging that a false statement was made to the SEC in a matter within its jurisdiction where, although describing the commodities business involved, the indictment does not include within its description of the business allegations of involvement in the limited class of transactions arguably within the jurisdiction of the SEC. The scope of SEC jurisdiction over the commodities business is an

[1] The Seventh Circuit had held in *Milnarik* v. *M-S Commodities, Inc.*, 457 F. 2d 274 (7th Cir. 1972), cert. den. 409 U.S. 887 (1972), that discretionary trading accounts were not within the jurisdiction of the SEC and had held in *Glazer* v. *National Commodity Research & Statistical Service, Inc.*, 547 F. 2d 392 (7th Cir. 1977), that commodity options were not within the jurisdiction of the SEC.

issue that has divided the Circuits and is one which is ripe for resolution by this Court. Insofar as the court below held that the indictment's description of petitioner's business was sufficient to support its facial validity despite the failure to allege participation in any forms of trading even arguably within the jurisdiction of the SEC, the decision below conflicts with the holdings of other courts and should be reversed.

18 U.S.C. § 1001 punishes false statements made "in any matter within the jurisdiction of any department or agency of the United States." As alleged in the indictment, petitioner operated a business which sold commodity options to the public and in the course of that business bought and sold commodity futures, utilizing the services of various brokerage houses. The indictment charged that petitioner submitted documents containing false statements concerning his business to the SEC and that those statements were made in a matter within the jurisdiction of the SEC (App. 14a-17a). Petitioner submits that, as described in the indictment, the commodities business in which he was engaged was not subject to the jurisdiction of the SEC and that, therefore, the court below erred in holding the indictment sufficient to state an offense.

The SEC is not empowered to regulate or investigate any and all wrongdoing in the commercial world. It is empowered only to investigate possible violations of the securities laws — to conduct investigations for the purpose of determining whether there have been violations within the scope of its regulatory jurisdiction as defined in the Securities Acts of 1933 and 1934.[2]

As the court below stated, "[a]t the time the SEC began its investigation in 1973, there was general agreement that com-

[2]In holding that the indictment sufficiently alleged agency jurisdiction over petitioner's business activities, the court below specifically noted that it was relying on the regulatory jurisdiction of the SEC and not on its statutory authority to investigate (App. 6a).



modity futures contracts were not securities and therefore not subject to regulation under the Securities Act of 1933" (App. 7a). Nor, under a well-reasoned line of cases in the Seventh Circuit, are discretionary trading accounts or commodity future options "investment contracts" within the meaning of the securities laws as defined by this Court in *SEC* v. *W.J. Howey Co.*, 328 U.S. 293 (1946).[3] See, e.g., *Milnarik* v. *M-S Commodities, Inc.*, 457 F. 2d 274 (7th Cir. 1972), cert. den. 409 U.S. 887 (1972), and *Hirk* v. *Agri-Research Council, Inc.*, 561 F. 2d 96 (7th Cir. 1977) (holding that discretionary trading accounts were not investment contracts within the meaning of the securities laws), and *Glazer* v. *National Commodity Research & Statistical Service, Inc.*, 547 F. 2d 392 (7th Cir. 1977) (holding that commodity future options are not investment contracts within the meaning of the securities laws).[4]

[3]The *Howey* test states: "an investment contract for purposes of the Securities Act means a contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party . . .." *Id.* at 298-299. The test is the same under both the Securities Act of 1933 and the Securities and Exchange Act of 1934. *Tcherepnin* v. *Knight*, 389 U.S. 332, 335-336 (1967). This Court has more recently construed the application of the *Howey* test in *United Housing Foundation, Inc.* v. *Forman*, 421 U.S. 837 (1975), and *International Brotherhood of Teamsters* v. *Daniel*, 439 U.S. 551 (1979).

[4]In *Glazer*, the court held that the failure to cover options sold to investors with actual purchases of futures contracts (which is the worst inference which can be drawn from the allegations of the indictment), although it may constitute a fraud or breach of contract by the broker, does not retroactively render the sale of an option an "investment contract" or security subject to the securities laws. *Glazer* v. *National Commodity Research*, *supra*, 547 F. 2d at 393. And see the District Court opinion, 388 F. Supp. 1341, 1344-1345 (N.D. Ill. 1974), adopted by the court on appeal. See also the discussion of the legislative history of the Commodity Futures Trading Commission Act, *infra*, in support of contention that naked options were not within the purview of SEC jurisdiction.

Petitioner submits that these cases were correctly decided and that the SEC possessed no jurisdiction over the commodity business in which petitioner was engaged.[5] As Congress clear-

[5]The history of the regulation of the commodities industry further supports petitioner's contention that his business was not subject to the jurisdiction of the SEC. Jurisdiction over commodity futures trading was given to the Commodity Exchange Commission by the Act of September 21, 1922, c. 369, § 1, 42 Stat. 99 — the Grain Futures Act. This statute regulated certain enumerated agricultural commodities (7 U.S.C. § 2) and prohibited trading in options on futures in such commodities entirely (7 U.S.C. § 6c). Trading in futures or options on commodities not listed in the Act remained unregulated. See S. Rep. No. 93-1131, 93d Cong., 2d Sess., reprinted in 1974 U.S. Code Cong. Adm. News 5859; see also 120 Cong. Rec. 30458 (1974) (remarks of Sen. Talmadge); 120 Cong. Rec. 10747 (1974) (remarks of Rep. Thoune); 120 Cong. Rec. 10726 (1974) (remarks of Rep. Poage); and *Review of Commodity Exchange Act and Discussion of Possible Changes: Hearings before the Committee on Agriculture*, H. Rep., 93d Cong., 1st Sess. 26 (1973) (statement by Alex C. Caldwell, Administrator, Commodity Exchange Authority, U.S.D.A.).

During the same New Deal years which gave birth to the Securities and Exchange Commission, the Grain Futures Act was amended to create a Commodity Exchange Commission within the Department of Agriculture and to enlarge the list of regulated commodities. Act of June 15, 1936, c. 545, § 1, 49 Stat. 1491. The Commodity Exchange Act remained in substantially the same form until 1974. Presumably aware that a regulatory scheme governing trading in commodity futures and commodity options had been in existence since 1922, Congress did not find it necessary to mention commodity futures or commodity options in defining the regulatory powers of the Securities and Exchange Commission in the Securities Act of 1933 (15 U.S.C. § 77b(1) (1970)) and the Securities Exchange Act of 1934 (15 U.S.C. § 78c(10) (1970)).

The impetus for the substantial revisions of the Commodity Exchange Act in 1974 (enacted under the title "Commodity Futures Trading Commission Act of 1974," October 23, 1974, Pub. L. 93-463, 88 Stat. 1389), was precisely the lack of any federal regulation of futures trading and option trading in commodities not listed in the existing statute. Congressional concern was fueled by the enormous increase in trading in both regulated and nonregulated commodities in the late 1960's and early 1970's, with the concomitant potential for abuse or fraud. See, *Review of Commodity Exchange Act* (statement by Alex C. Caldwell), *supra*, at 26 ("Unregulated futures markets [in such commodities as lumber, plywood, sugar, silver, coffee, etc.] are



ly believed when it passed the Commodity Futures Trading Commission Act of 1974, commodity option trading was either prohibited by the Commodity Exchange Act or entirely unregulated and, as the Seventh Circuit court has clearly held, commodity option trading could not be shoehorned into the mold of an "investment contract" subject to the securities laws and the jurisdiction of the SEC. Accordingly, in the absence of regulatory jurisdiction, an indictment which requires as an essential element of the offense charged that a false statement be made in a matter within the jurisdiction of the SEC must be held invalid.

growing rapidly — yet no federal agency is responsible for preventing price manipulation or curbing excess speculation in them. In addition, traders have no federal protection against fraud or embezzlement . . ..") See also 120 Cong. Rec. 10740 (1974) (remarks of Rep. Brown) ("There has been a vast increase in futures trading with no commensurate increase in regulatory attention. Nonregulated commodities volume has quadrupled over the past four years with no federal regulation whatsoever. This has allowed naked options trading and pyramid schemes to flourish under existing law."), and remarks of Rep. Poage, 120 Cong. Rec. 10736 (1974).

To remedy this situation, Congress enlarged the jurisdiction of the new Commodity Futures Trading Commission to include the regulation of all commodities traded in the United States and to include options trading in all commodities in which such trading was not prohibited by the extant statute. See, 7 U.S.C. §§ 2, 6a, as amended by Act of October 23, 1974, Pub. L. 93-463, 88 Stat. 1389.

A proposal to place futures trading regulation in the hands of the SEC was briefly entertained in the House Committee on Agriculture and rejected on the ground that the commodities markets differ *toto coelo* from the securities markets and regulation of the two types of market requires vastly different expertise. H. Rep. No. 93-975, 93d Cong., 2d Sess. (1974), pp. 70-71: "The possibility seemed to terrify experts on futures trading who appeared before the Full Committee . . .. Neither is it a welcome prospect at the S.E.C."

Thus, it is abundantly clear that at the time that the SEC undertook to investigate petitioner's business affairs in 1973, option trading in such nonagricultural commodities as silver lay in a regulatory void and that neither the SEC nor any other federal agency had the authority to regulate futures or options trading in commodities not listed in the Commodity Exchange Act.

Nonetheless, without rejecting its prior holdings, the court below found that the fact that other courts had concluded that discretionary trading accounts and naked double options were subject to SEC supervision[6] sufficed to confer the agency jurisdiction required to state an offense under 18 U.S.C. § 1001, stating that "if the SEC investigation demonstrated that [petitioner's] business had used discretionary commodity trading accounts or had traded in naked double options, [petitioner's] trading arguably would have been within the SEC's regulatory jurisdiction" (App. 8a).

Aside from the failure of the factual allegations in the indictment to allege participation in such forms of trading (an omission which petitioner submits is fatal in and of itself, see *infra*), petitioner submits that the "arguable jurisdiction" relied on by the court below is insufficient to provide the requisite agency jurisdiction in this case. Jurisdiction either exists or it does not. As set forth above, for the reasons set forth in *Milnarik*, *Glazer* and *Hirk*, and based on the legislative history of the various commodities acts, petitioner urges this Court to hold that the SEC had no jurisdiction over petitioner's commodity business — a holding that would clearly render the indictment invalid for failure to state an offense.

Moreover, the principle of *stare decisis* requires governmental compliance with judicial limitations imposed upon its activities even if it believes those limitations to be erroneous. The government simply cannot be free to ignore limitations on the scope of its authority imposed by the court, but, like all citizens, must abide by judicial rulings unless and until such rulings are vacated or reversed by higher authority. The activities alleged in the indictment were conducted in Illinois. The United States Court of Appeals for the Seventh Circuit, whose jurisdiction covers Illinois, has definitively held that

[6] See, e.g., cases cited at App. 8a.



neither discretionary trading accounts nor commodity options are within the purview of SEC jurisdiction. The existence of contrary decisions elsewhere cannot provide the government with carte blanche to ignore the clear mandate of the court in the jurisdiction in which it seeks to act. In deferring to "arguable jurisdiction" the court below erroneously deferred to an abuse of agency authority, and the decision below should be reversed.

## II. Where, in an Indictment Charging a Violation of 18 U.S.C. § 1001, the Nature of Petitioner's Commodity Business is Set Forth in a Number of Factual Allegations in the Indictment, the Failure to Allege Affirmatively that his Business was Engaged in Any of the Limited Class of Transactions Even Arguably Within the Jurisdiction of the Securities and Exchange Commission Renders the Indictment Facially Insufficient for Failure to State an Essential Element of the Offense Charged — i.e., Agency Jurisdiction over Petitioner's Business.

Although recognizing that the factual allegations concerning the nature of petitioner's business operations could vitiate the general conclusion that the false statements were made in a matter within the jurisdiction of the SEC, thereby rendering the indictment insufficient for failure to state an offense (App. 4a-5a), the court below affirmed petitioner's conviction because the factual allegations did not preclude the possibility that petitioner's business was engaged in two particular forms of commodity trading — discretionary trading accounts or naked double options — which, according to the court, could arguably have fallen within the jurisdiction of the SEC

(App. 8a). In so holding the court below impermissibly relieved the government of its affirmative burden of setting forth a "definite written statement of the essential facts constituting the offense charged" as required by Rule 7 of the Federal Rules of Criminal Procedure and affirmed the validity of an indictment on the basis of uncharged hypotheticals.

Petitioner's business is described in the indictment as one "which sold commodity options to the public" and as a "commodity option business" (App. 14a). It is also alleged that "[a]s part of his operation of the commodity option business . . . [petitioner caused the companies] to buy and sell commodity futures" (App. 14a). Nowhere is it alleged that petitioner's business dealt in naked double options or discretionary trading accounts — the only type of transactions which, as the court noted, would arguably have subjected petitioner's business to SEC jurisdiction (see App. 8a).[7]

Nonetheless, despite the total absence of affirmative allegations to bring the petitioner's business within the arguable purview of SEC jurisdiction, the court below found that because the description of petitioner's business did not affirmatively preclude the possibility that the business activities were arguably within that jurisdiction, the indictment was facially sufficient.

Petitioner submits that this analysis stands the requirements of Rule 7 of the Federal Rules of Criminal Procedure on their head. An indictment must *affirmatively state the essential facts* of the offense. Accordingly, the sufficiency of an indictment must be judged on the basis of what it in fact alleges and not, as the court below held, on the basis of what it could have alleged. To permit an indictment to stand on the basis of what could have been alleged ignores the basic principle that,

[7] As the court noted, neither conventional commodity option contracts nor commodity futures were securities within the jurisdiction of the SEC (App. 8a n.5).



> "The failure of an indictment to detail each element of the charged offense generally constitutes a fatal defect. . . . It is of paramount importance to the rights of the accused that the indictment contain an adequate recitation of each component of the crime that the Government must establish." *United States* v. *King*, 587 F. 2d 956, 963 (9th Cir. 1978).

See also *Russell* v. *United States*, 369 U.S. 749, 765-766 (1962).

That the factual allegations in the indictment must be considered in judging its sufficiency, and that factual allegations can render an indictment insufficient for failure to state an offense despite the tracking of statutory language in another section of the indictment, were the predicates for the court's reversal of convictions in *Marteney* v. *United States*, 216 F. 2d 760 (10th Cir. 1954). There, the defendant pleaded guilty to an indictment purporting to charge violations of 18 U.S.C. § 2314. He challenged his conviction on the ground that the counts to which he had pleaded guilty failed to state a federal offense. Holding that a claim of failure to state an offense is cognizable despite a guilty plea, the court examined the indictment as a whole, stating:

> "We haven't any doubt that an allegation charging the unlawful interstate transportation of a 'falsely made, forged, altered, or counterfeited security', purporting to be a warehouse receipt . . . states an offense in the words of Section 2314 . . .. But the counts involved in this indictment did not stop with the statement of the offense in the words of the statute. They went on to affirmatively allege in what factual respect the warehouse receipts were 'falsely made . . .'. This allegation is not mere surplusage which may be stricken from the indictment

> . . .; it was obviously intended to critically describe the nature of the document or instrument transported in interstate commerce. If the instrument thus described is not one, the transportation of which is condemned by federal statute, no offense is stated." 216 F. 2d at 763.

In the case before it the court found that the factual description removed the documents from the purview of the statute, and, accordingly, held the indictment insufficient to state an offense.

Similarly, here, although the allegations in paragraph 2 of counts 2 and 3 track the statutory language, the indictment did not stop there. Rather, it set forth numerous factual allegations which attempt to establish and describe the basis of SEC jurisdiction. Since, however, they fail to do so, here, as in *Marteney*, no offense has been stated and the indictment is facially insufficient.

In *King*, *supra*, defendant Deal, identified as a physician in the indictment, was charged with conspiracy to possess with intent to distribute cocaine. The indictment did not indicate whether the defendant was a practitioner who could, by reason of that fact, be permitted to distribute cocaine for a legitimate medical purpose in the usual course of his professional practice. The court held that this omission rendered the indictment defective for failure to charge an essential element — the lack of authorization to dispense cocaine by means of acting outside the scope of the medical exception. The factual allegation in the indictment — i.e., that the defendant was a physician — did not support the general legal conclusion that he unlawfully conspired to possess with intent to distribute cocaine.[8] To the contrary, it raised the possibility that the conclusion was invalid. The failure to allege affirmatively that he acted outside the scope of the medical exception was, therefore, fatal.

[8] It should be noted that had the factual allegations not stated that defendant was a physician, the indictment would, in all likelihood, have been sufficient.



Here, as in *King*, the factual allegations that petitioner operated a commodities option business do not support the general legal conclusion that the business' activities were within the scope of SEC jurisdiction, but, to the contrary, raise the distinct possibility that they were not, since only two types of activities have been found to be even arguably within the jurisdiction of the SEC and neither of those activities was mentioned in the indictment. Accordingly, here, the failure to allege affirmatively involvement in the particular types of activities within SEC jurisdiction renders the indictment defective. That it could have so charged — a possibility that remains totally within the realm of the hypothetical since there is nothing to indicate that such was the nature of petitioner's business — is irrelevant.

*United States* v. *Seeger*, 303 F. 2d 478 (2d Cir. 1962), presents an analogous situation. There defendant was charged with violating 2 U.S.C. § 192 by refusing to answer questions asked by a subcommittee of the Committee on Un-American Activities of the House of Representatives. One of the essential elements of the offense was the authority of the subcommittee to conduct the investigation. The indictment alleged that the committee was duly created and authorized by statute and had directed that an investigation be conducted pursuant to that authorization, and that pursuant to its direction a duly authorized subcommittee was holding hearings. *Id.*, at 481 n.5. It failed to allege affirmatively facts indicating the subcommittee's authority. The court held that the indictment failed to state an offense. In so holding, the court noted that, in fact, subcommittee authorization may well have existed. However, the government's failure to set that authority out as part of the indictment was fatal. Again, the fact that allega-

tions could have been made to render the indictment facially sufficient was deemed irrelevant.

Just as in *Seeger*, the factual allegations failed to support affirmatively the general legal conclusion of subcommitte authority, so here, the factual allegations fail to support affirmatively the general legal conclusion of SEC jurisdiction. Again, the speculative possibility — unsupported by the indictment — that petitioner's business dealt in naked double options or discretionary trading accounts is an insufficient basis for finding that the indictment properly alleged that the false statements were within the jurisdiction of the SEC as required to constitute the offense charged.

To paraphrase the court's conclusions in *Marteney* v. *United States*, 216 F. 2d 760, 763 (10th Cir. 1954), here the factual allegations were "obviously intended to critically describe the nature [of petitioner's business in order to establish that it was subject to SEC jurisdiction and i]f the [business] thus described is not one [subject to SEC jurisdiction], no offense is stated." The business described in the preliminary paragraphs of the indictment is clearly not one which — on the basis of the facts alleged — could be found to have been conducting activities within the jurisdiction of the SEC. If the government proved everything affirmatively alleged, no offense would have been proved. Thus the indictment, as drafted, failed to state an offense. The possibility that a valid indictment could have been drafted — a possibility which remains just that — cannot relieve the government of its affirmative obligations to present an indictment stating the essential facts necessary to constitute the offense charged.



**Conclusion.**

For all the foregoing reasons, this petition for a writ of certiorari should be granted.

Respectfully submitted,

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Appendix.

In the

# United States Court of Appeals

## For the Seventh Circuit

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No. 79-1142

UNITED STATES OF AMERICA,

*Plaintiff-Appellee,*

*v.*

LUIGI M. DI FONZO,

*Defendant-Appellant.*

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Appeal from the United States District Court for the Northern District of Illinois, Eastern Division.
No. 78 CR 56—**Stanley J. Roszkowski**, *Judge*.

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ARGUED JUNE 13, 1979—DECIDED AUGUST 2, 1979

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Before SWYGERT and CUMMINGS, *Circuit Judges*, and CAMPBELL, *Senior District Judge*.[1]

SWYGERT, *Circuit Judge*. The principal question raised by this appeal concerns the scope of the Security Exchange Commission's ("SEC") "jurisdiction" pursuant to 18 U.S.C. § 1001, a statute which punishes false statements made "in any matter within the jurisdiction of any department or agency of the United States." We hold that the false statements submitted by defendant to the SEC were within that agency's jurisdiction and affirm his conviction.

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[1] The Honorable William J. Campbell, United States Senior District Judge for the Northern District of Illinois, Eastern Division.

I

Defendant Luigi M. DiFonzo operated a business which sold commodity options to the public. From January 1973 to May 1973 this business operated under the name "North American Commodity Options Exchange, Inc." From May 1973 to January 1974 the business was named "North American Investments Company, Inc." Defendant bought and sold commodity futures through these two corporations, utilizing the services of several brokerage houses.

In early 1973 the Chicago Regional Office of the SEC began to investigate defendant and his investment company. During this investigation defendant submitted to the SEC documents issued by Siegal Trading Company, Inc. ("Siegal"), a brokerage house with which defendant had an account. The SEC investigation eventually discovered that defendant had altered figures in these documents in order to make his investment company appear more solvent.

On February 1, 1978 defendant was charged in a three count indictment with presenting documents to the SEC which contained false statements in violation of 18 U.S.C. § 1001.[1] Count I charged that defendant presented the SEC with a document which purported to confirm defendant's purchase (through Siegal) of thirty-two silver futures commodity contracts when, in fact, Siegal had made no such purchase for defendant's account. Counts II and III alleged that defendant submitted documents to the SEC which overstated the balance of two accounts defendant had with Siegal.

[2] 18 U.S.C. § 1001 provides:

> Whoever, in any matter within the jurisdiction of any department or agency of the United States knowingly and willfully falsifies, conceals or covers up by any trick, scheme, or device a material fact, or makes any false, fictitious or fraudulent statements or representations, or makes or uses any false writing or document knowing the same to contain any false, fictitious or fraudulent statement of entry, shall be fined not more than $10,000 or imprisoned not more than five years, or both.



Numerous pretrial motions were filed by defendant including a motion to dismiss the indictment for failure to state an offense under 18 U.S.C. § 1001 on the ground that the indictment on its face alleged facts showing that the SEC did not have jurisdiction over defendant's activities and that, therefore, the alleged false statements were neither made in nor material to a matter within the jurisdiction of the SEC. The district court denied this motion.

On December 21, 1978 defendant entered a plea of guilty to Counts II and III of the indictment. The Government dismissed Count I of the indictment and the district court entered judgment. Sentence was entered January 30, 1979. On February 9, 1979 defendant filed this appeal.

II

The Government argues that we need not reach the question whether defendant's false statements were within the jurisdiction of the SEC pursuant to 18 U.S.C. § 1001, because the defendant, by pleading guilty to the charge brought by the Government under the statute, waived his right to contest the issue on appeal. Defendant responds that if, as he contends, the false statements did not pertain to a matter within the jurisdiction of the SEC, the indictment fails to state an offense and therefore the general rule that a guilty plea bars subsequent attacks on a conviction does not apply.

It is well established that a valid guilty plea waives objections based on most prior defects in the Government's prosecution of a defendant. *See Coleman v. Burnett*, 477 F.2d 1187, 1194 (D.C.C. 1973), and cases cited therein. It is equally well established that if a defendant contends that his indictment was so defective that it failed to charge an offense, his plea of guilty does not bar his subsequent challenge to the indictment on appeal. *Id.* at 1194, n. 20; *Melvin v. United States*, 316 F.2d 647, 648 (7th Cir. 1963). The scope of such a challenge to the sufficiency of the indictment, however, is not unrestricted. The defendant is not permitted to transcend the four-corners of the indictment in order to

demonstrate its insufficiency. *Melvin, supra*, 316 F.2d at 648. And a guilty plea is an admission of all the factual allegations contained in the indictment. *Coleman, supra*, 477 F.2d at 1193; *United States v. Singletary*, 441 F.2d 333 (5th Cir. 1971). As we said in *United States v. Friedman*, 416 F.2d 947, 949 (7th Cir. 1969), "In the absence of any factual determination below construing the indictment, defendant's voluntary and knowing plea of guilty is an admission to all the stated allegations of the indictment . . . ." In essence, a defendant who has pleaded guilty must show that the words and allegations of the indictment on its face failed to state an offense in order to challenge successfully his conviction on appeal.

The Government correctly observes that Counts II and III of the indictment against defendant each contain an allegation that defendant presented a false statement to the SEC "in a matter within the jurisdiction of the S.E.C." Given the fact that a guilty plea constitutes an admission to the allegations of the indictment, this jurisdictional allegation normally would preclude any appellate inquiry concerning the SEC's jurisdiction vis-a-vis defendant's false statements. The indictment against defendant, however, also contains preliminary factual allegations describing defendant's business operations. Defendant argues that these facts preclude the conclusion of Counts II and III that defendant's false statements were in a matter within the jurisdiction of the SEC. In effect, defendant contends that the indictment contradicts itself on its face: Counts II and III assert that SEC jurisdiction was present, while the preliminary factual allegations demonstrate that defendant's business activities could not be within the legitimate purview of the SEC. *See* Reply Brief for Defendant-Appellant, pp. 4-5, n. 3.

We agree with defendant's position that appellate review of his conviction is available on these grounds. If defendant can demonstrate that the preliminary factual allegations of the indictment preclude the indictment's later conclusion that his false statements pertained to a matter within the jurisdiction of the SEC, he will have shown that the indictment contradicts itself, and, more



importantly, that the preliminary factual allegations of the indictment negate one of the elements of the offense charged. He will have shown that the indictment "fails to state an offense," which is an infirmity in the Government's prosecution which survives a defendant's guilty plea.

Although we agree with defendant's position on the preliminary issue of whether his appeal survives his plea of guilty, we disagree with his contention that the preliminary factual allegations of the indictment, on their face, preclude a conclusion that the false statements he presented to the SEC related to a matter with the SEC's jurisdiction. The Supreme Court said in *Bryson v. United States*, 396 U.S. 64 (1969):

> Because there is a valid legislative interest in protecting the integrity of official inquiries, *see United States v. Bramblett*, 348 U.S. 503 (1955); *United States v. Gilliland*, 312 U.S. 86, 93 (1941), we think the term "jurisdiction" should not be given a narrow or technical meaning for purposes of § 1001, *Ogden v. United States*, 303 F.2d 724, 742-43 (C.A. 9th Cir. 1962); *United States v. Adler*, 380 F.2d 917, 921-922 (C.A. 2d Cir. 1967). A statutory basis for an agency's request for information provides jurisdiction enough to punish fraudulent statements under § 1001.

*Id.* at 70-71. The Government contends that the statutory jurisdiction of the SEC for purposes of the jurisdictional requirement of section 1001 "goes beyond the Commission's statutory authority to regulate, and includes their authority to investigate to determine whether securities laws are being violated."[3] Brief of Plaintiff-

[3] The SEC's investigatory authority is rooted in two statutory provisions:

15 U.S.C. § 77t(a) provides that:

> When ever it shall appear to the Commission, either upon complaint or otherwise, that the provisions of this subchapter, or of any rule or regulation proscribed under authority thereof, have been or are about to be violated, it may, in its discretion, either require or permit such

(Footnote continued on following page)

Appellee, p. 10. We need not decide whether statutory authority to investigate, without more, is sufficient to satisfy the jurisdictional requirement of section 1001.[4] In this case there was a sufficient nexus between the subject matter of the SEC investigation which led to defendant's submission of false documents to the SEC and the SEC's regulatory authority to satisfy the jurisdiction requirement of section 1001.

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[3] *continued*

person to file with it a statement in writing, under oath, or otherwise, as to all the facts and circumstances concerning the subject matter which it believes to be in the public interest to investigate, and may investigate such facts.

And 15 U.S.C. § 78u(a) states:

> The Commission may, in its discretion, make such investigations as it deems necessary to determine whether any person has violated, is violating, or is about to violate any provisions of this chapter, the rules or regulations thereunder, the rules of a national securities exchange or registered securities association of which such person is a member or a person associated with a member, the rules of a registered clearing agency in which such person is a participant, or the rules of the Municipal Securities Rulemaking Board, and may require or permit any person to file with it a statement in writing, under oath or otherwise as the Commission shall determine, as to all the facts and circumstances concerning the matter to be investigated.

[4] In *Friedman v. United States*, 374 F.2d 363 (8th Cir. 1967), the Eighth Circuit held that a false statement given to the FBI in order to precipitate a federal prosecution under the Civil Rights Laws was not related to a matter within the jurisdiction of any department or agency for purposes of section 1001 because although the FBI "had authority to investigate" it had "no power to adjudicate rights, establish binding regulations, compel the action or finally dispose of the problem giving rise to the inquiry." *Id.* at 368. *Contra United States v. Adler*, 380 F.2d 917 (2d Cir. 1967). *See also United States v. Isaacs*, 493 F.2d 1124 (7th Cir.), *cert. denied*, 417 U.S. 976-77 (1974). In *Bryson* the Supreme Court acknowledged *Friedman* and explicitly indicated that *Bryson* neither approved nor disapproved *Friedman*'s holding.



Because of his guilty plea, defendant must demonstrate that the description of his business activities found in the preliminary factual allegations of the indictment, given the applicable law, negates the indictment's conclusory allegation that the false statements made by defendant (and the SEC investigation which prompted them) were within the SEC's jurisdiction. *See, supra*, pp. 3-5. The preliminary factual allegations of the indictment state that defendant "operated a business which sold commodity options to the public . . . [and] caused [his business] to buy and sell commodity futures by use of various commodity brokerage firms." This description of defendant's activities does not absolutely remove them from the legitimate purview of the SEC. Thus, the SEC investigation into these activities had a sufficient jurisdictional base to satisfy the requirement of section 1001.

At the time the SEC began its investigation in 1973, there was general agreement that commodity futures contracts were not securities and therefore not subject to regulation under the Securities Act of 1933. *See Milnarik v. M-S Commodities, Inc.*, 457 F.2d 274, 275 n. 1 (7th Cir.), *cert. denied*, 409 U.S. 887 (1972). And in *Milnarik*, we held that a discretionary trading account in commodity futures was not a security. *Id.* This view was confirmed and expanded in several later decisions. *See Hirk v. Agri-Research Council, Inc.*, 561 F.2d 96 (7th Cir. 1977); *Glazer v. National Commodity Research and Statistical Service, Inc.*, 547 F.2d 392 (7th Cir. 1977). Defendant argues that these decisions and the legislative history underlying various Congressional enactments (particularly the Commodity Exchange Act of 1974) demonstrate that the SEC could have had no regulatory authority over defendant's commodity trading activities.

Defendant's position neglects two important facts. First, although the Seventh Circuit decision in *Milnarik* held that discretionary trading accounts in commodities were not subject to SEC regulation, a prior district court decision from the Second Circuit had reached the opposite conclusion. *See Maheu v. Reynolds & Co.*, 282 F. Supp. 423, 426 (S.D.N.Y. 1967). And several decisions

subsequent to *Milnarik* refused to follow the Seventh Circuit and instead concluded that discretionary trading accounts in commodities were subject to SEC supervision. *See SEC v. Continental Commodities Corp.*, 497 F.2d 516 (5th Cir. 1974); *Marshall v. Lamson Bros.*, 368 F. Supp. 486 (S.D. Ia. 1974). *See also SEC v. Commodity Options Inter., Inc.*, 553 F.2d 628 (9th Cir. 1977) ("naked double options" constitute securities); *SEC v. American Commodity Exchange, Inc.*, 546 F.2d 1361 (10th Cir. 1976).[5] And even our decision in *Hirk* required a reevaluation of *Milnarik* in light of the Fifth Circuit's decision in *Continental Commodities. Hirk, supra*, 561 F.2d at 100-01. The rule regarding SEC jurisdiction over certain forms of commodity trading was not firmly settled; if the SEC investigation demonstrated that defendant's business had used discretionary commodity trading accounts or had traded in naked double options, defendant's trading arguably would have been within the SEC's regulatory jurisdiction. And there is nothing in the indictment's description of defendant's business which precludes the possibility that his business participated in these forms of commodity trading.

The second deficiency in defendant's position is that it fails to give sufficient consideration to the preliminary nature of the SEC investigation which precipitated

[5] At page 17 of its brief the Government asserted, "While this Court held in 1972 that commodity option contracts were not securities, other circuits had held otherwise," and cited cases purportedly supporting this proposition. The Government's statement is misleading, at best. In fact, none of the cases cited by the Government held that conventional commodity option contracts were securities. *But see SEC v. American Commodity Exchange, Inc.*, 546 F.2d 1361, 1366 (10th Cir. 1976) (dicta). Instead, two of these cases dealt with trading in naked double options and the rest with discretionary trading accounts. In fact, several of these decisions explicitly distinguished the trading they were concerned with from trading in either commodity futures contracts, *see e.g., SEC v. Continental Commodities Corp.*, 497 F.2d 516, 520 n. 9 (5th Cir. 1974); *Maheu v. Reynolds & Co.*, 282 F. Supp. 423, 426 (S.D.N.Y. 1967), or conventional commodity option contracts. *See SEC v. Commodity Options Inter., Inc.*, 553 F.2d 628, 630-31 (9th Cir. 1977).



defendant's submission of false statements to the SEC. In an analogous context, it has long been settled that questions about SEC regulatory jurisdiction should not be decided in subpoena enforcement actions. *SEC v. Savage*, 513 F.2d 188, 189 (7th Cir. 1975); *SEC v. Brigadoon Scotch Distributing Co.*, 480 F.2d 1047, 1052-53 (2d Cir. 1973), *cert. denied*, 415 U.S. 915 (1974); *SEC v. Wall Street Transcript Corp.*, 422 F.2d 1371 (2d Cir. 1970). *See also Oklahoma Press Publishing Co. v. Walling*, 327 U.S. 186, 201 (1946). As we said in *Savage*, to hold otherwise "would require SEC to answer at the outset of its investigation the possibly doubtful questions of fact and law that the investigation is designed and authorized to illuminate." *Savage, supra*, 513 F.2d at 189.

The same reasoning applies here. The SEC began an investigation in a field in which it arguably possessed regulatory authority and defendant submitted false statements to the SEC in the course of that investigation. To conclude that section 1001 does not apply if a defendant ultimately can show that the false statements he submitted pertained to matters outside the regulatory jurisdiction of the SEC would cripple the SEC's preliminary investigatory capacities, thereby frustrating its ability to make an intelligent, independent assessment of whether it possesses regulatory authority over a given person's activities. Thus when, as here, there is a nexus between a person's business activities and the regulatory authority of the SEC and the SEC initiates an investigation into those activities, any false statements submitted to the SEC pursuant to the investigation are subject to prosecution under 18 U.S.C. § 1001.

Finally, defendant contends that his conviction should be overturned because his false statement were not "material" to a matter within the jurisdiction of the SEC. Defendant's argument is based on the conclusion of several circuits that materiality is an essential element of a section 1001 conviction. *See, e.g., United States v. Beer*, 518 F.2d 168 (5th Cir. 1975); *United States v. Deep*, 497 F.2d 1316 (9th Cir. 1974). The test of the materiality of a statement is "whether a statement 'has a natural tendency to influence, or was capable of influenc-

ing, the decision of the tribunal in making a determination required to be made.'" (Citations omitted.) *Beer, supra*, 518 F.2d at 171. *See also Deep, supra*, 497 F.2d at 1321. And the Fifth Circuit in *Beer* added:

> [T]he cases previously cited on the requirement of materiality are in agreement that the agency need not actually have relied or acted to its detriment upon the false statement, but the government must still show that the statement had the capacity to influence a determination required to be made.

*Beer, supra*, 518 F.2d at 172.

As defendant's brief notes, the "requirement of 'agency jurisdiction' and 'materiality' are logically related." Brief for Defendant-Appellant, p. 21, n.14. In order for the SEC to make an informed decision about whether it possessed jurisdiction or whether any suspicious business activities worthy of continued investigation had transpired, it needed to request preliminary information from defendant. And the false statements submitted by defendant in response to the SEC request were capable of influencing these essential agency decisions. Thus, the materiality requirement was satisfied.

Defendant's conviction is affirmed.

A true Copy:
Teste:

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*Clerk of the United States Court of Appeals for the Seventh Circuit*



United States Court of Appeals
FOR THE SEVENTH CIRCUIT

CHICAGO, ILLINOIS 60604

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*August 2, 1979*

Before

Hon. LUTHER M. SWYGERT, Circuit Judge
Hon. WALTER J. CUMMINGS, Circuit Judge
Hon. WILLIAM J. CAMPBELL, Senior District Judge*

No. 79-1142

| | |
|---|---|
| UNITED STATES OF AMERICA,<br>PLAINTIFF-APPELLEE,<br><br>*vs.*<br><br>LUIGI M. DIFONZO,<br>DEFENDANT-APPELLANT. | Appeal from the United States District Court for the Northern District of Illinois Eastern Division<br>No. 78-Cr-56<br>STANLEY J. ROSKOWSKI, Judge |

This cause came on to be heard on the transcript of the record from the United States District Court for the Northern District of Illinois, Eastern Division, and was argued by counsel.

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* The Honorable William J. Campbell, United States Senior District Judge for the Northern District of Illinois, Eastern Division.

On consideration whereof, it is ordered and adjudged by this court that the judgment of the said District Court in this cause appealed from be, and the same is hereby, AFFIRMED, in accordance with the opinion of this court filed this date.



# United States Court of Appeals
For the Seventh Circuit

CHICAGO, ILLINOIS 60604

*October 15, 1979*

Before

Hon. LUTHER M. SWYGERT, Circuit Judge
Hon. WALTER J. CUMMINGS, Circuit Judge
Hon. WILLIAM J. CAMPBELL, Senior District Judge*

No. 79-1142

| | |
|---|---|
| UNITED STATES OF AMERICA,<br>PLAINTIFF-APPELLEE,<br><br>*vs.*<br><br>LUIGI M. DIFONZO,<br>DEFENDANT-APPELLANT. | Appeal from the United States District Court for the Northern District of Illinois, Eastern Division.<br>No. 78-Cr-56<br>Judge STANLEY J. ROSZKOWSKI |

On consideration of the petition for rehearing and suggestion for rehearing *in banc* filed in the above-entitled cause by counsel for the defendant-appellant, no judge in active service has requested a vote thereon, and all of the judges on the original panel have voted to deny a rehearing. Accordingly,

IT IS ORDERED that the aforesaid petition for rehearing, be, and the same is hereby, DENIED.

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* Honorable William J. Campbell, Senior District Judge of the Northern District of Illinois, Eastern Division is sitting by designation.

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

UNITED STATES OF AMERICA No. 78 CR-56
*v.*
LUIGI M. DiFONZO

Violation: Title 18, United States Code, Section 1001

The SPECIAL FEBRUARY 1975 GRAND JURY charges:

1. From in or about January 1973, to in or about January 1974, Luigi M. DiFonzo operated a business which sold commodity options to the public. Between in or about January 1973, and in or about May 1973, Luigi M. DiFonzo operated the commodity option business using the name North American Commodity Options Exchange, Inc. From in or about May 1973, to in or about January 1974, Luigi M. DiFonzo operated the commodity option business using the name North American Investments Company, Inc.

2. As a part of his operation of the commodity option business described in paragraph one, Luigi M. DiFonzo caused North American Commodity Options Exchange, Inc. and North American Investments Company, Inc. to buy and sell commodity futures by use of various commodity brokerage firms.

3. One of the commodity brokerage firms from which North American Commodity Options Exchange, Inc. and North American Investments Company, Inc. bought and sold commodity futures was the Siegel Trading Company, Inc. (hereinafter referred to as Siegel).

4. The commodity futures account with Siegel used by North American Commodity Options Exchange, Inc. and North American Investments Company, Inc. was opened by



Luigi M. DiFonzo on or about March 23, 1973. The account was entitled "NACOE, Inc." and was numbered 61125. Account 61125 remained open and commodity futures trades were negotiated by Luigi M. DiFonzo through that account until on or about July 30, 1973.

5. During the period between on or about March 23, 1973 and on or about July 30, 1973, Siegel periodically issued and submitted to Luigi M. DiFonzo documents pertaining to account number 61125, which documents reflected trades of commodities futures, commodities futures positions and account balances. These documents included Confirmations, Statements of Account — Purchase and Sale, and Statements of Account — Open Trades.

6. In or about July, 1973, representatives of the Securities and Exchange Commission (hereinafter referred to as the S.E.C.) conducted an examination of the books and records, and the related supporting documents of North American Investments Company, Inc., including the Confirmations, Statements of Account — Purchase and Sale, and Statements of Account — Open Trades issued and submitted by Siegel.

7. In or about July, 1973, at Des Plaines, in the Northern District of Illinois, Eastern Division, and elsewhere,

LUIGI M. DiFONZO,

defendant herein, in a matter within the jurisdiction of the S.E.C., an agency of the United States, did wilfully and knowingly make and use and caused to be made and used a document containing a materially false, fictitious and fraudulent statement, knowing the document to contain the false, fictitious and fraudulent statement; in that the defendant submitted to a representative of the S.E.C. a false, fictitious and fraudulent document purporting to be a Siegel "Confirmation" for account number 61125 and dated May 31, 1973.

8. The above described document contained a false, fictitious and fraudulent statement in that it stated and represented in substance that on May 31, 1973, thirty-two silver futures commodity contracts were purchased for the acount when, in fact, on that date Siegel purchased no silver futures contracts for the account and had issued no such Confirmation;

In violation of Title 18, United States Code, Section 1001.

## Count Two

The Special February 1975 Grand Jury further charges:

1. The grand jury repeats and realleges the allegations of paragraphs one through six of Count One as set forth fully herein.

2. In or about July, 1973, at Des Plaines, in the Northern District of Illinois, Eastern Division, and elsewhere,

LUIGI M. DiFONZO,

defendant herein, in a matter within the jurisdiction of the S.E.C., an agency of the United States, did wilfully and knowingly make and use and caused to be made and used a document containing a materially false, fictitious and fraudulent statement, knowing the document to contain the false, fictitious and fraudulent statement; in that the defendant submitted to a representative of the S.E.C. a false, fictitious and fraudulent document purporting to be a Siegel "Statement of Account — Purchase and Sale" for account number 61125 and dated May 29, 1973.

3. The above described document contained a false, fictitious and fraudulent statement in that it stated and represented in substance that on May 29, 1973, the account had a balance



of $190,955.00 when, in fact, on that date the account at Siegel had a balance of $115,559.72.

In violation of Title 18, United States Code, Section 1001.

## Count Three

The Special February 1975 Grand Jury further charges:

1. The grand jury repeats and realleges the allegations of paragraphs one through six of Count One as set forth fully herein.

2. In or about July, 1973, at Des Plaines, in the Northern District of Illinois, Eastern Division, and elsewhere,

LUIGI M. DiFONZO,

defendant herein, in a matter within the jurisdiction of the S.E.C., an agency of the United States, did wilfully and knowingly make and use and caused to be made and used a document containing a materially false, fictitious and fraudulent statement, knowing the document to contain the false, fictitious and fraudulent statement; in that the defendant submitted to a representative of the S.E.C. a false, fictitious and fraudulent document purporting to be a Siegel "Statement of Account — Open Trades" for account number 61125 and dated May 31, 1973.

8. The above described document contained a false, fictitious and fraudulent statement in that it stated and represented in substance that on May 30, 1973, the account had an "excess initial" balance of $157,645.00 when, in fact, on that date the "excess initial" balance at Siegel was $82,249.72;

In violation of Title 18, United States Code, Section 1001.

A True Bill:

*Foreman*

United States Attorney.